

Internal Revenue Service

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Department of the Treasury
Washington, DC 20224

Third Party Communication: None
Date of Communication: Not Applicable

Person To Contact:
, ID No.

Telephone Number:

Refer Reply To:
CC:PSI:B03
PLR-136941-08

Date:
November 20, 2008

Legend

Company =

Trust1 =

Trust2 =

Shareholder =

State =

Date1 =

Date2 =

Date3 =

Date4 =

Date5 =

Dear :

This letter responds to a letter dated August 13, 2008, and subsequent correspondence, submitted on behalf of Company, requesting a ruling under § 1362(f) of the Internal Revenue Code.

Facts

Company was incorporated under the laws of State on Date1. Company elected to be treated as an S corporation effective Date2. Shareholder transferred all of Shareholder's shares in Company to Trust1 on Date3. Company represents that Trust1 was a grantor trust and thus an eligible S corporation shareholder under § 1361(c)(2)(A)(i).

Shareholder died on Date4. The shares in Company held by Trust1 were distributed to Trust2 on Date5. Company represents that at all times Trust2 satisfied the requirements to be treated as a qualified subchapter S trust ("QSST") under § 1361(d). However, an election under § 1361(d)(2) to treat Trust2 as a QSST was not timely filed.

Company represents that Company and its shareholders have at all times intended Company to be an S corporation, and have treated Company consistent with this intent. Company also represents that Company and its shareholders have reported their income consistent with Company being an S corporation. Company further represents that the failure to timely file a QSST election for Trust2 was inadvertent and not motivated by hindsight. In addition, Company represents that, other than the failure to file a QSST election for Trust2, Company has met the definition of an S corporation under § 1361(a)(1). Company and all of its shareholders consent and agree to make any adjustments consistent with the treatment of Company as an S corporation as may be required by the Secretary under § 1362(f).

Law and Analysis

Section 1361(a)(1) provides that the term "S corporation" means, with respect to any taxable year, a small business corporation for which an election under section 1362(a) is in effect for such year.

Section 1361(b)(1)(B) provides that a "small business corporation" cannot have as a shareholder a person (other than an estate, a trust described in § 1361(c)(2), or an organization described in § 1361(c)(6)) who is not an individual.

Section 1361(c)(2)(A)(i) provides that a trust, all of which is treated (under subpart E of part I of subchapter J of Chapter 1) as owned by an individual who is a citizen or resident of the United States, is a permitted shareholder of a small business corporation.

Section 1361(c)(2)(A)(ii) provides that a trust which was described in § 1361(c)(2)(A)(i) immediately before the death of the deemed owner and which continues in existence after such death, but only for the 2-year period beginning on the day of the deemed owner's death, is a permitted shareholder of a small business corporation.

Section 1361(d)(1) provides that, in the case of a QSST with respect to which a beneficiary makes an election under § 1361(d)(2), the trust is treated as a trust described in § 1361(c)(2)(A)(i) and, for purposes of § 678(a), the beneficiary of the trust is treated as the owner of that portion of the trust which consists of stock in an S corporation with respect to which the election under § 1361(d)(2) is made.

Section 1361(d)(2)(A) provides that a beneficiary of a QSST (or his legal representative) may elect to have § 1361(d) apply.

Section 1361(d)(3) provides that the term “qualified subchapter S trust” means a trust, (A) the terms of which require that – (i) during the life of the current income beneficiary, there shall be only one income beneficiary of the trust, (ii) any corpus distributed during the life of the current income beneficiary may be distributed only to such beneficiary, (iii) the income interest of the current income beneficiary in the trust terminates on the earlier of the beneficiary’s death or the termination of the trust, and (iv) upon the termination of the trust during the life of the current income beneficiary, the trust distributes all of its assets to that beneficiary, and (B) all of the income (within the meaning of § 643(b)) which is distributed (or required to be distributed) currently to one individual who is a citizen or resident of the United States.

Section 1362(a) provides, in part, that a small business corporation may elect to be an S corporation.

Section 1362(d)(2)(A) provides that an election under § 1362(a) shall be terminated whenever (at any time on or after the 1st day of the 1st taxable year for which the corporation is an S corporation) such corporation ceases to be a small business corporation.

Section 1362(f) provides, in part, that if (1) an election under § 1362(a) by any corporation was terminated under § 1362(d)(2), (2) the Secretary determines that the circumstances resulting in such termination were inadvertent, (3) no later than a reasonable period of time after discovery of the circumstances resulting in such termination, steps were taken so that the corporation is a small business corporation, and (4) the corporation, and each person who was a shareholder in the corporation at any time during the period specified pursuant to § 1362(f), agrees to make such adjustments (consistent with the treatment of the corporation as an S corporation) as may be required by the Secretary with respect to such termination period, then, notwithstanding the circumstances resulting in the termination, the corporation shall be treated as an S corporation during the period specified by the Secretary.

Conclusion

Based on the information submitted and representations made, we conclude that Company’s S corporation election terminated on Date5, when shares of Company were

distributed to Trust2. Because Trust2 failed to make a timely QSST election, Trust2 was an ineligible S corporation shareholder under § 1361(b)(1). We further conclude that the termination was inadvertent within the meaning of § 1362(f).

Under § 1362(f), Company will be treated as if it were an S corporation from Date2 and thereafter, provided a QSST election with an effective date of Date5 is filed with the appropriate service center within 60 days from the date of this letter, and Company's S corporation election was otherwise valid and not otherwise terminated under § 1362(d). Accordingly, Company's shareholders, in determining their respective income tax liabilities during the termination period and thereafter, must include their pro rata share of the separately and non-separately computed items of Company as provided in § 1366, make any adjustments to stock basis as provided in § 1367, and take into account any distributions made by Company as provided by § 1368. If Company or any of the shareholders fail to treat Company as described above, this ruling shall be void. A copy of this letter should be attached to the QSST election.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter. Specifically, no opinion is expressed or implied concerning whether Company was and is an S corporation for federal tax purposes. Further, no opinion is expressed or implied concerning whether Trust2 meets the requirements of § 1361(d)(3).

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

Pursuant to a Power of Attorney on file with this office, we are sending a copy of this letter to your authorized representative.

Sincerely,

/s/

Leslie H. Finlow
Senior Technician Reviewer, Branch 3
Office of the Associate Chief Counsel
(Passthroughs & Special Industries)

Enclosures (2)

Copy of this letter
Copy for § 6110 purposes

cc: